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IN THE

# Supreme Court of the United States

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LEHMAN BROTHERS BANK, FSB,
*Petitioner*,

v.

STATE BANK COMMISSIONER,
*Respondent*.

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**On Petition for a Writ of Certiorari to the Supreme Court of Delaware**

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## BRIEF OF *AMICUS CURIAE* U.S. BANCORP IN SUPPORT OF PETITIONER

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## BRIEF OF *AMICUS CURIAE* U.S. BANCORP IN SUPPORT OF PETITIONER

## INTEREST OF *AMICUS CURIAE*

This brief *amicus curiae* in support of Petitioner is filed on behalf of U.S. Bancorp ("Bancorp").[1] Bancorp is a publicly held multi-state financial holding company with operations in all fifty States and several foreign jurisdictions. U.S. Bank Trust National Asso-

[1] The parties have consented to the filing of this brief. Counsel of record for all parties received notice at least ten days prior to the due date of the *amicus curiae*'s intention to file this brief. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae* made a monetary contribution to the brief's preparation or submission.

ciation ("Trust") is a wholly-owned subsidiary bank of Bancorp's lead bank, U.S. Bank National Association, which has operations in New York and Delaware. Trust is the resulting company from a merger of two separate trust banks in 2002—one that was headquartered in New York, and one that was headquartered in Delaware—to streamline operations and reduce the number of legal entities owned by Bancorp.

As of December 31, 2007, Trust employed five persons in Delaware, and sixty people in New York. The company is domiciled in Delaware, but nearly all of its employees and most of its activity are in the New York trust office. After the merger of the two companies, Trust filed the requisite tax returns in both Delaware and New York, apportioning the income of the company to the two States according to their respective apportionment statutes.

The Delaware Banking Commissioner took issue with the apportionment of the income and issued deficiency notices to Trust, indicating that it was not eligible to apportion its income outside of Delaware because it did not have either a "branch" or a "subsidiary" conducting its out-of-state activity.

Trust pays the Delaware bank franchise tax at issue in this case. Like petitioner, Trust's business operations do not require, and Trust does not operate, its national banking business through federally approved branches or through subsidiaries. The decision of the Delaware Supreme Court upholding as constitutional the unapportioned tax on a taxpayer doing business in multiple States results in Trust paying tax on one hundred percent of its nationwide income to Delaware. This result occurs solely because Trust does not operate through branches or sub-

sidiaries, which Delaware arbitrarily requires as condition of a taxpayer's right to apportion its income.[2] The Delaware statute denies this right to Trust regardless of the extent of its out-of-state activities and despite the fact that Trust, as a bank limited to trust powers, is not even permitted to operate through branches.

## SUMMARY OF ARGUMENT

This case raises the fundamental question of whether a State may tax one hundred percent of the income of a corporation whose income is also subject to tax in other States in which it conducts its interstate business. Settled Commerce Clause doctrine provides a negative answer to this question, for to hold otherwise would expose a taxpayer to the type of multiple taxation that the Commerce Clause forbids. *Amicus* recognizes that this Court has granted great flexibility to States in fashioning their own methods of apportionment as long as those methods are "'fairly calculated' to assign to [a State] that portion of net income 'reasonably attributable' to the business done [in that State]," *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 273 (1978). Such flexibility, however, does not encompass the right to deny apportionment altogether when other States have the right to tax a portion of the taxpayer's income.

The constitutional flaw in the Delaware statute is not a defect unique to that State. New Jersey, West Virginia, and Georgia each employ tax regimes

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[2] U.S. Bancorp adopts, for purposes of its brief in support of the Petition, the definitions of "branch" and "subsidiary" utilized by the Delaware Supreme Court below.

that expose taxpayers to a similar risk of multiple taxation and reinforce the need for this Court's review of the case.

## ARGUMENT

### I. THE DECISION BELOW RUNS ROUGHSHOD OVER BEDROCK COMMERCE CLAUSE DOCTRINE.

#### A. The Commerce Clause Bars A Domiciliary State From Taxing On An Unapportioned Basis Values That Other States Have Power To Tax On An Apportioned Basis.

The court below concluded that Delaware may tax the unapportioned income that a Delaware domiciliary bank derived from its interstate mortgage banking business, despite undisputed evidence that the bank had more than one hundred out-of-state employees through which it conducted a substantial portion of its mortgage banking activity. Pet. App. at 7. This ruling flies in the face of the fundamental Commerce Clause principle that no State may tax on an unapportioned basis values which other States may tax on an apportioned basis.

This Court's Commerce Clause doctrine has long protected taxpayers from the risk of improper multiple taxation. *See, e.g, J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938) (condemning tax that subjects "[i]nterstate commerce . . . to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids"). Accordingly, a taxpayer that can demonstrate that it is taxable in another State has a right to divide its tax base. Thus, a taxpayer located in State A that shows it is taxable in State B has a constitutional

right to insist that State A recognize its right to divide its tax base between the States, attributing at least a portion of the overall tax base—whether it be property, income, or receipts—to State B. The logical underpinning for this rule is irrefutable: If a taxpayer is taxable in more than one State, denial by either State of the right to division of the tax base would expose the taxpayer to an unconstitutional risk of multiple taxation.

This Court articulated the underlying principle in *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952). The taxpayer, an Ohio-based corporation, owned boats and barges that it employed for the transportation of oil along the Mississippi and Ohio Rivers. The vessels, though registered in Cincinnati, made only occasional stops in Ohio for repairs. Their main terminals were in other States. Ohio assessed an ad valorem personal property tax on the unapportioned value of the vessels. This Court had recently sustained the power of a nondomiciliary State to tax an apportioned share of the value of vessels that operated within the State in *Ott v. Mississippi Valley Barge Line Co.*, 336 U.S. 169 (1949). Ohio contended that *Ott* did not deprive the domiciliary State of the power to tax the entire value of the vessels, a power the domiciliary State possessed under the Court's earlier doctrine. This Court flatly rejected Ohio's contention. Observing that earlier cases sustaining the power of the domiciliary State to tax the full value of personal property were predicated on the fact that the property had not acquired a taxable situs elsewhere, this Court declared that these cases

> have no application here since most, if not all, of the barges and boats which Ohio has taxed were almost continuously outside Ohio during

> the taxable year. . . . [M]ost, if not all, of them were operating in other waters and therefore under *Ott v. Mississippi Barge Line Co.* . . . could be taxed by the several states on an apportionment basis. *The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile* . . . . Otherwise there would be multiple taxation of interstate operations and the tax would have no relation to the opportunities, benefits, or protection which the taxing state gives those operations.

*Standard Oil*, 342 U.S. at 384-85 (emphasis supplied).

This Court has steadfastly adhered to the view that the power of one State to tax an interstate enterprise's property or income on an unapportioned basis cannot be sustained when other States have the power to tax such property or income on an apportioned basis. Thus, in *Central Railroad Co. v. Pennsylvania*, 370 U.S. 607 (1962), this Court, while sustaining the power of the State to impose a tax on the unapportioned value of the taxpayer's rolling stock because it had failed to establish that it was subject to an apportioned tax elsewhere, nevertheless observed that "multiple taxation of interstate operations . . . offends the Commerce Clause," *id.* at 612, and "multiple taxation is possible . . . if there exists some jurisdiction, in addition to the domicile of the taxpayer, which may constitutionally impose an ad valorem tax." *Id.* Likewise, in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this Court, in delineating the constitutional restraints on State taxation of the instrumentalities of commerce under the Commerce Clause, unequivocally declared that "[t]he corollary of the apportionment principle,

of course, is that no jurisdiction may tax the instrumentality in full." *Id.* at 447.

In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), this Court reaffirmed the rule precluding one State from taxing the unapportioned share of a tax base that is taxable by apportionment in other States in the context of State taxation of income. *Mobil* presented the question whether Vermont could tax an apportioned share of dividends that Mobil Oil Corporation, a New York domiciliary, received from its foreign subsidiaries. Mobil had challenged the inclusion of such dividends in its apportionable tax base under the Commerce Clause, contending, among other things, that there was a risk of multiple taxation on the ground that New York, the State of its commercial domicile, had the power to tax one hundred percent of its dividends, and that Vermont's assertion of the right to tax an apportioned share of such dividends therefore exposed it to multiple taxation. Vermont countered that there was no violation of the multiple taxation principle because the New York statute did not in fact tax such dividends.

This Court rejected the underlying argument that only New York could tax the income. After reiterating the fundamental principle that "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate," *id.* at 444, this Court declared:

> The reasons for allocation to a single situs that often apply in the case of property taxation carry little force in the present context. Mobil no doubt enjoys privileges and protections conferred by New York law with respect to ownership of stock holdings, and its activities in that State no doubt

> supply some nexus for jurisdiction to tax. . . . Although we do not presume to pass on the constitutionality of a hypothetical New York tax, we may assume, for the present purposes, that the State of commercial domicile has the power to lay *some* tax on the appellant's dividend income. *But there is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method.*

*Id.* at 445-46 (emphasis supplied).

In short, the Commerce Clause precludes one State from denying a taxpayer the right to a division of the tax base when a portion of that tax base is taxable by other States. By allowing Delaware to tax one hundred percent of the taxpayer's income the Delaware Supreme Court violated this Commerce Clause principle. This Court's intervention is necessary to correct the plain error of the ruling below, which can only cause additional mischief if left undisturbed.

### B. The Court Below Erred In Holding That The Taxpayer Must Demonstrate Actual Multiple Taxation Rather Than The Risk Of Multiple Taxation To Establish A Commerce Clause Violation.

In holding that Delaware's unapportioned tax survived scrutiny under the Commerce Clause, the court below relied in part on the fact that the "the Bank failed to prove 'by clear and cogent evidence' precisely

what income (if any) was taxed by other states," *Lehman Bros. Bank, FSB v. State Bank Comm'r*, 937 A.2d 95, 113 (Del. 2007) , and "nothing in the record establishes actual multiple taxation or a significant threat thereof."[3] The court committed plain error in suggesting that anything other than the risk of multiple taxation is the relevant constitutional inquiry for the right to apportionment.

In delineating the Commerce Clause doctrine forbidding multiple taxation, this Court has made it clear that it is the mere *risk*—not the actuality or significant threat—of multiple taxation that gives rise to the Commerce Clause claim. Thus, in *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939), this Court stated:

> Here the tax, measured by the entire volume of the interstate commerce in which appellant participates, is not apportioned to its activities within the state. If Washington is free to exact such a tax, other states to which the commerce extends may, with equal right, lay a tax similarly measured for the privilege of conducting within their respective territorial limits the activities there which contribute to the service. The present tax, though nominally local, thus in its practical operation discriminates against interstate commerce, since it imposes upon it, merely because interstate commerce is being done, *"the risk of a multiple burden to which local commerce is not exposed."*

*Id.* at 439 (quoting *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938) (emphasis supplied).

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[3] While the Delaware Supreme Court referred to a "significant threat" standard, its focus was entirely on whether there was proof of actual multiple taxation.

More recent decisions have put the matter to rest by reaffirming that the risk, and not the actuality or significant threat, of multiple taxation suffices to establish a constitutional violation. In holding squarely that the Commerce Clause protects taxpayers against the risk of multiple taxation, this Court in *Mobil* declared:

> Inasmuch as New York does not presently tax the dividends in question, actual multiple taxation is not demonstrated on this record. The Vermont courts placed some reliance on this fact, and much of the debate in this Court has aired the question whether an actual burden need be shown. *We agree with Mobil that the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy.*

*Mobil Oil*, 445 U.S. at 444 (emphasis supplied). *See also Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 228-29 (1980) (reaffirming "risk" rule of multiple taxation).

The Delaware Supreme Court's misguided reliance on proof of actual multiple taxation as an essential predicate of a Commerce Clause violation compounds its error of denying apportionment despite the unquestioned authority of other States to tax a portion of petitioner's income, and reinforces the need for this Court's review.

## II. THE CONSTITUTIONAL PROBLEM WITH THE DELAWARE STATUTE EXISTS IN OTHER STATES.

The constitutional problem raised by the Delaware statute is presented by similar statutes in other

States, reinforcing the need for this Court's intervention to correct the plain error of the decision below.[4]

### A. New Jersey Imposes A "Regular Place Of Business" Requirement As A Condition of the Right to Apportion

Under a regime analogous to Delaware's "subsidiary or branch" rule, New Jersey imposes a "regular place of business" requirement before a corporation may apportion its income. A New Jersey corporation with taxable income producing activities in other States is subject to tax on one hundred percent of its income unless the corporation has a "regular place of business" in another State. N.J. Stat. Ann. § 54:10A-6. New Jersey defines "regular place of business" to include *only* "any bona fide office . . . , factory, warehouse, or other space of the taxpayer which is *regularly maintained*, occupied and used by the taxpayer in carrying on its business *and in which one or more regular employees are in attendance.*" N.J. Admin. Code 18:7-7.2 (emphasis supplied). Like Delaware's "branch or subsidiary" rule, New Jersey's definition of "regular place of business" is narrower than the range of taxable activities in which a taxpayer could engage in generating income in other States, thereby exposing the taxpayer to the risk of multiple taxation.

Under the New Jersey framework, common business practices arise in which a taxpayer performs taxable income producing activities in other States

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[4] Delaware amended its bank franchise tax statute in 2007. The provision at issue in this case remains part of the statute and the 2007 amendment added an alternative tax calculation that suffers from similar constitutional problems as the provision at issue here.

yet would still be required to apportion one hundred percent of its income to New Jersey merely because those activities did not rise to level of a "regular place of business." For example, an information service provider (such as a credit check service) could have sales people, technicians, and customer support personnel frequently visit other States but because such activity did not provide a "space" "regularly maintained" by the taxpayer, the taxpayer would be subject to tax on one hundred percent of its income in New Jersey. The same would be true for a taxpayer that actually has a sales office in another State, but the sales office is staffed with independent contractors. Because the office did not have a "regular employee[] in attendance," the taxpayer would be subject to New Jersey tax on one hundred percent of its income even if *all* of its sales were generated through this out-of-state office.

The parallels between Delaware's "branch or subsidiary" rule and New Jersey's "regular place of business" rule arbitrarily conditioning a taxpayer's right to apportion its income without regard to its activities in other States are self-evident.

### B. West Virginia Prohibits Domestic Financial Organizations From Apportioning Their Income Regardless Of Their Taxable Activities In Other States.

West Virginia imposes a corporate net income tax on financial organizations. W. Va. Code § 11-24-4. In principle, West Virginia tax law permits taxpayers that have business activity that is taxable within and without West Virginia to apportion their income. However, the statute further specifies that financial

organizations that are commercially domiciled in West Virginia *are not considered subject to tax in other jurisdictions*. W. Va. Code § 11-24-7 (emphasis supplied). West Virginia's statute therefore subjects domiciliary financial institutions to tax on one-hundred percent of their income regardless of their taxable activities in other states. Once again, the analogy to Delaware's unconstitutional tax regime is self-evident.

### C. Georgia Attributes All Assets Of A Domestic Corporation To The State.

Like New Jersey and West Virginia, Georgia deprives taxpayers of the right to apportion their tax base, though the taxpayer may be taxable in other States. Georgia imposes a net worth tax calculated using the total value of assets of a corporation. Ga. Code Ann. § 48-13-72. Domestic corporations are taxed on the full value of assets no matter where located. *Id; State of Georgia, Form IT-611 2007 Corporate Income Tax Forms and Instructions.*[5] The statute makes no attempt to distinguish between in-state and extraterritorial values of a commercially domiciled multistate taxpayer.

In short, it is apparent that the fundamental defect in the Delaware statute is not unique to Delaware. Several other States have taxing statutes with similar constitutional defects which reinforce the need for this Court's intervention in the present case.

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[5] Georgia permits foreign corporations to apportion their net worth tax based on the ratio of in-state assets to out-of-state assets. Ga. Code § 48-13-75.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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